United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

77-6003

UNITED STATES COURT OF APPEALS
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IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA and
DENNIS J. HERZOG, Special Agent,
Internal Revenue Service,
Petitioners-Respondents,

VS.

ASPHALT MATERIALS, INCORPORATED,
CHARLES HALL, President,
Respondents-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NEW YORK.

BRIEF FOR RESPONDENTS-APPELLANTS

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UNITED STATES OF AMERICA and
DENNIS J. HERZOG, Special Agent,
Internal Revenue Service

Petitioners-Respondents

-vs-

DOCKET NO.
77-6003

ASPHALT MATERIALS, INCORPORATED
CHARLES HALL, President

Respondents-Appellants

BRIEF FOR RESPONDENTS-APPELLANTS

Preliminary Statement

This is an appeal by the Respondents-Appellants, Asphalt Materials, Incorporated, and Charles Hall, its President, from an order of Honorable John T. Elfvin, United States District Judge, Western District of New York dated November 19, 1976, ordering that respondents-appellants comply with an Internal Revenue Service summons served upon respondent-appellant, Charles Hall, as President of Asphalt Materials Corp. on April 8, 1976, in the matter of the tax liability of Charles Hall, individually, for the period of 1972-1974. The summons, a copy of which is attached to the petition to enforce the summons, calls for the production of what amounts to all of the corporation's books and records for an unlimited period and bank statements and cancelled checks for a period of seven years from 1967-1974.

The Special Agent had served an earlier summons relative to the same subject on March 12, 1976. A copy of that summons appears as Exhibit "B" accompanying the respondents-appellants answering affidavit on the motion. Respondents-appellants declined to comply.

The moving papers of the petitioners-respondents, United States of America, and Dennis J. Herzog, Special Agent, Internal Revenue Service consist of the summons of April 8, 1976, a petition signed by an Assistant United States Attorney and the supporting affidavit of the petitioner-respondent, Dennis J. Herzog.

The basis for the petition to enforce is covered in paragraphs II and VIII in which it is asserted that the summons was issued by the Special Agent under the authority of Section 7602 of the Internal Revenue Code; that the records and testimony sought are not already in the possession of the Internal Revenue Service and that no recommendation for prosecution of the taxpayer has been made to the United States Department of Justice. In paragraph IX, it is asserted that it is "essential" to the determination of the tax liabilities of Charles Hall to have the records and testimony "as is evidenced by the affidavit of the petitioner, Special Agent, Dennis J. Herzog."

The affidavit of Special Agent, Dennis J. Herzog, states at paragraph VIII the testimony and records demanded are "necessary" for the determination of the tax liabilities of Charles Hall.

In their answering affidavit the respondents-appellants asserted the following position:

1. Section 7602 of the Internal Revenue Code requires that the documents or testimony sought must be "relevant or material to such inquiry."

2. That neither the petition or the supporting affidavit disclosed a single allegation claiming that the documents or testimony sought is relevant or material to petitioner's purpose.

3. Furthermore, not a single fact was alleged which could support such a position.

4. The petitioner's application failed to comply with the requirements of IRS standards in seeking enforcement of its summons.

5. There was a demonstrable lack of good faith in the entire method of procedure violative of respondents-appellants constitutional rights.

Oral arguments were presented on November 1, 1976, at which time the U. S. Assistant arguing the case for the Government admitted that the summons was issued as part of a criminal investigation of respondent-appellant, Charles Hall, and to build a criminal tax case against him. By Memorandum and Order dated November 13, 1976, respondents-appellants were ordered to comply with the summons served on April 8, 1976. The Court did not order a hearing to determine the sufficiency of the Government's papers or if the IRS summons was issued primarily as part of a criminal investigation of the respondents-appellants.

Appeal Questions Involved

1. Were the Government's moving papers sufficient under the provisions of Sec. 7602 of the Internal Revenue Code to support the determination of the Court that the respondents-appellants comply with the IRS summons of April 8, 1976?

2. Was the Court in error in not ordering a hearing to determine if the issuance of the summons was motivated by prosecutorial intent?

RESPONDENT-APPELLANT'S POSITION

POINT I

THE GOVERNMENT FAILED TO COMPLY WITH THE LAW AND ITS OWN RULES IN MOVING FOR ENFORCEMENT OF THE IRS SUMMONS

Section 7602 of the Internal Revenue Code which is the authority under which the IRS summons herein concerned was issued states as follows:

> "SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized-
>
> (1) To examine any books, papers, records, or other data which may be *relevant or material* to such inquiry;

> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be *relevant or material* to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be *relevant or material* to such inquiry."
> (emphasis supplied)

The statutory requirement that the testimony or documents sought must be "relevant or material" (recited three times in the section) either means something or it doesn't. The District Court said that relevancy is determined "by reading the summons itself" (p. 30 Memorandum and Order) but adds "in light of the purpose and extent of the tax investigation." What *is* the purpose and extent of this particular investigation? While the Court found its answer in reading the face of the summons alone, it is submitted that this inquiry cannot be satisfied from a mere reading of the face of the summons.

Likewise, the answer to the question cannot be found by reading the petition and supporting affidavit submitted by the Government because they are silent on the subject. Those documents do not contain a single allegation or fact to support the proposition that the documents or testimony sought is "relevant or material" to

the petitioners' purpose.

Strangely enough, it is the Government who has attempted to demonstrate that the expression "relevant or material" required by Section 7602 really does mean something and the answer is found in the "Handbook for Special Agents", Section 267.2(1) and (5). In these two subsections, the handbook warns special agents of the code requirement to show relevancy and materiality but also warns that "A reasonable basis for making the inquiry must exist."

Speaking to the subject of supporting affidavits in an enforcement proceeding, the Handbook states the following in Sec. 268.3(1):

> "To support applications for Court orders directing compliance with a summons, the agent may be requested by the United States Attorney to prepare an affidavit . . . reciting *detailed* information concerning the nature and purpose of the examination, the testimony and records desired and their relevancy to the examination" (emphasis supplied)

Since the Government has failed completely to disclose why the testimony and documents are "relevant or material" the Court had no basis on which to make its determination that "[A]n examination of the summons reveals that the items to be produced are highly relevant . . . . " (p. 30 Memorandum and Order) unless it first ordered a hearing to determine the purpose and extent of this tax investigation. This the Court did not do.

POINT II

THE DISTRICT COURT SHOULD HAVE ORDERED A HEARING TO DETERMINE THE VALIDITY OF THE GOVERNMENT'S POSITION AND TO DETERMINE IF THE ISSUANCE OF THE IRS SUMMONS WAS MOTIVATED BY PROSECUTORIAL INTENT

Judge Elfvin stated in his Memorandum and Order of November 19, 1976, that no evidence had been presented to show that Special Agent Herzog had formed a firm purpose to recommend prosecution and did not order a hearing to determine if this was in fact the case despite the admissions of the Assistant United States Attorney who argued the motion. The United States Attorney said that the records and testimony "are relevant *obviously* to a criminal investigation against Mr. Hall and/or the corporation." Again, at another point, "There could hardly be any more relevant and material inquiry *when you seek to build a criminal tax case* against a president of a company. . . . " (p. 22 Hearing Transcript) (emphasis supplied)

Finally, when pressed by the Court as to the legitimacy of such a subpoena when the inquiry would be of a criminal nature, the U. S. Assistant insisted that complaince must prevail because "the summons on its face will allow that." (p. 25 Hearing Transcript)

At an earlier point, the question was raised as to the purpose and extent of this particular investigation. These candid and most enlightening admissions by the United States Assistant leave no doubt that the sole purpose of this tax investigation is, to put in the United States Assistant's own words, "to build a *criminal* tax case against a president of a company." (emphasis supplied)

The question of purpose of motivation behind the issuance of an IRS summons has been recently reviewed in the case of United States v. Wright Motor Company, Inc., 536 F.2d 1090(5th Cir. 1976). In that case, as in this, a summons was issued to the president of a company and to the company for the purpose of investigating his personal tax liability. He declined to appear and declined to produce the corporate records. In the subsequent enforcement proceedings, the issue of the Government's motivation was raised. The Court ordered the deposition of the Government Special Agent and the Government appealed when the Special Agent was ordered to answer questions about a criminal investigation of the taxpayer. The Special Agent refused to answer the questions.

In its opinion, the Court reviews the law where the issue of motivation in issuing an IRS summons has come up and discusses their earlier decision in United States v. Roundtree, 420 F.2d 845 (5th Cir. 1969) where they had reversed a District Court's enforcement of an IRS summons because the District Court had refused to allow a taxpayer to discover, on deposition, whether the sole purpose of the summons was to further a criminal prosecution.

Speaking of their earlier decision, in Roundtree, supra, as it relates to the later Donaldson case which held in part that a summons enforcement proceeding may be used even if it is possible that recommendation for criminal prosecution may be forthcoming, the Court said at p. 1094:

> "We understand Roundtree, supra, to have established the principle that when a taxpayer alleges in a responsive pleading that the material sought by the IRS is to be used solely for a criminal prosecution, or that the IRS is engaged upon a course of personal harassment, the taxpayer is entitled to investigate the IRS' purposes through deposition of the special agent. We do not believe that either Donaldson or Newman reversed our holding in Roundtree that discovery procedures may be invoked for the limited purpose of determining whether the IRS has employed its summons powers for an improper purpose. Donaldson does not actually consider the procedures for investigating the IRS' purposes, but, in recognizing that where the 'sole objective of the investigation is to obtain evidence for use in a criminal prosecution, the purpose is not a legitimate one and enforcement may be denied,' 400 U.S. at 533, 91 S.Ct. at 543, we believe the Court impliedly recognized that a taxpayer may investigate, through discovery, the government's purposes. We read Donaldson as not forbidding the denial of enforcement of an administrative summons issued solely for the investigation of criminal charges even though no recommendation for prosecution has been made. United States v. Zack, 521 F.2d 1366, 1368 (9th Cir. 1975), United States v. Weingarden, 473, F.2d 454, 460 (6th Cir. 1973)."

Again, the Court points out the importance of allowing the taxpayer his opportunity to explore the question of Government motivation when it states at p. 1095 of its opinion:

> "Although we believe that the government is correct in its contention that a valid civil purpose for an investigation is sufficient to allow the enforcement of a summons, United States v. Moore, 485 F.2d 1165 (5th Cir. 1973), we do not believe that discovery should be denied upon the government's bare assertion of its existence because a "summonee must be afforded at least *some* opportunity to substantiate its allegations.' United Staces v. Church of Scientology, 520 F.2d 818, 824 (9th Cir. 1975) (italics in original)."

> Accordingly, we hold that the district court did not err in ordering the special agent to answer questions inquiring whether the summons was issued solely for a criminal prosecution of taxpayer."

While the District Court in this case alluded to the Government's concession as being one that the investigation might lead to criminal prosecution, the record discloses that the Government's statement was much stronger and a clear cut declaration that this *is* a *criminal* investigation of Charles Hall and *the building of a criminal tax case against him.*

Under such circumstances due to the paucity of facts to substantiate the application for enforcement in the first place and the admission that the Government is attempting to use a civil procedure to conduct a criminal investigation the application for the enforcement of the summons should have been denied and the application dismissed.

Conclusion

The District Court was in error in holding that the relevancy or materiality of the testimony and records sought of respondents-appellants could be determined by reference to the face of the summons alone. The hearing transcript admissions of the Assistant United States Attorney that the motivation in issuing the civil summons was to build a criminal case against respondent-appellant, Charles Hall, was sufficient grounds to dismiss the petitioner or, at the very least, cause a hearing to be conducted relative to such admissions. Failure to order such a hearing or dismiss the petition was likewise error on the part of the District Court Judge.

Respectfully submitted,
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